

less burdensome and more efficient regulatory compliance for common members and facilitating FINRA's performance of its regulatory functions under the 17d-2 Agreement. Accordingly, the Exchange has designated this rule filing as non-controversial under Section 19(b)(3)(A) of the Act<sup>18</sup> and paragraph (f)(6) of Rule 19b-4 thereunder.<sup>19</sup> In addition, in its guidance on the proposed rules of SROs,<sup>20</sup> the Commission concluded that filings based on the rules of another SRO already approved by the Commission are eligible for immediate effectiveness under Rule 19b-4(f)(6). The Commission noted that "a proposed rule change appropriately may be filed as an immediately effective rule so long as it is based on and similar to another SRO's rule and each policy issue raised by the proposed rule (i) has been considered previously by the Commission when the Commission approved another exchange's rule (that was subject to notice and comment), and (ii) the rule change resolved such policy issue in a manner consistent with such prior approval."<sup>21</sup> As discussed herein, the rule changes proposed herein are based on parallel NASDAQ and FINRA rules on arbitration and mediation. The proposed rule change would allow greater consistency between EDGX and FINRA rules, which should benefit EDGX and FINRA members, regulators, and the investing public. In addition, the Exchange requests the Commission waive the 30-day operative delay to provide greater harmonization between Exchange and FINRA rules, resulting in less burdensome and more efficient regulatory compliance for common members and facilitating FINRA's performance of its regulatory functions.

Based on the foregoing, the Commission believes that the proposed rule change should become immediately effective and waives the 30-day pre-operative waiting period contained in Rule 19b-4(f)(6)(iii) under the Act so that the Exchange may immediately implement this rule change.<sup>22</sup>

At any time within sixty (60) days of the filing of such proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of

investors, or otherwise in furtherance of the purposes of the Act.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-EDGX-2014-01 on the subject line.

##### *Paper Comments*

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-EDGX-2014-01. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-EDGX-2014-01 and should be submitted on or before February 26, 2014.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>23</sup>

Kevin M. O'Neill,

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-71447; File No. SR-Topaz-2014-04]

### Self-Regulatory Organizations; Topaz Exchange, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Related to Market Maker Risk Parameters

January 30, 2014.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 17, 2014, the Topaz Exchange, LLC (d/b/a ISE Gemini) (the "Exchange" or "Topaz") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend its rules to mitigate market maker risk by adopting an Exchange-provided risk management functionality.

The text of the proposed rule change is available on the Exchange's Internet Web site at <http://www.ise.com>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in

<sup>18</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>19</sup> 17 CFR 240.19b-4(f)(6).

<sup>20</sup> See Securities and Exchange Act Release No. 58092 (July 3, 2008), 73 FR 40144 (July 11, 2008).

<sup>21</sup> *Id.* at 40149.

<sup>22</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>23</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

Sections A, B and C below, of the most significant aspects of such statements.

*A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change*

1. Purpose

Pursuant to Topaz Rule 804, the Exchange automatically removes a market maker's quotes in all series of an options class when certain parameter settings are triggered. Specifically, there are currently four parameters that can be set by market makers on a class-by-class basis. These parameters are available for market maker quotes in single options series. Market makers establish a time frame during which the system calculates: (1) The number of contracts executed by the market maker in an options class; (2) the percentage of the total size of the market maker's quotes in the class that has been executed; (3) the absolute value of the net between contracts bought and contracts sold in an options class, and (4) the absolute value of the net between (a) calls purchased plus puts sold, and (b) calls sold plus puts purchased. The market maker establishes limits for each of these four parameters, and when the limits are exceeded within the prescribed time frame, the market maker's quotes in that class are removed or curtailed. It is mandatory for market makers to enter values into all four of the quotation risk management parameters for all options classes in which it enters quotes.<sup>3</sup>

The Exchange now proposes to enhance its risk management offering to further strengthen risk management for market maker quotes. While the parameters described in the preceding paragraph are set on a class-by-class basis, the Exchange now proposes to adopt functionality that will allow market makers to manage their risk across the entire market. Specifically, the Exchange proposes to adopt functionality to allow market maker quotes to be removed from the trading system if a specified number of curtailment events occur across the Topaz market. If the specified number of curtailment events is exceeded within the prescribed time period, the market maker's quotes in all classes in which it quotes will automatically be removed from the trading system.

As proposed, market makers must request the Exchange to set the proposed market wide parameter to govern its trading activity. Once this

parameter is set, the trading system will count the number of times a market maker's pre-set curtailment, as specified in Rule 804(g), has been triggered. Once the specified number of curtailment events has been reached, the trading system will remove all of the market maker's quotes in all classes in which it makes a market thereby reducing the risk to the market maker in the event the market maker is suffering from a systems issue or due to the occurrence of unusual or unexpected market activity. Any quotes sent by the market maker after the proposed market wide parameter has been triggered will be rejected until such time that the market maker notifies the Exchange that it is ready to come out of its curtailment. In the interests of maintaining fair and orderly markets, the Exchange believes it is important that market makers communicate their readiness to the Exchange in a non-automated manner, such as by email or telephone. Once notified by the market maker, the Exchange will reactivate the market maker's quotes and the market maker will once again be active in the options classes in which it makes markets.

As an example, suppose market maker ABCD, who makes a market in 50 options classes on the Exchange, sets the proposed market wide parameter so that it is triggered at 25 curtailment events within a 20 second time period. On a given trading day, if market maker ABCD is curtailed, within the prescribed time period, 25 times across all 50 options classes in which it makes a market then all of market maker ABCD's quotes on Topaz in all 50 options classes will be removed from the trading system. The 25 curtailment events can occur in just one class or any number of classes in which market maker ABCD makes a market on the Exchange.

While the proposed risk management functionality is a useful feature that serves an important risk management purpose, it operates consistent with the firm quote obligations of a broker-dealer pursuant to Rule 602 of Regulation NMS. Specifically, any marketable orders or quotes that are executable against a market maker's quotes that are received prior to the time this functionality is engaged will be automatically executed at the price up to the market maker's size, regardless of whether such execution results in executions in excess of the market maker's pre-set parameters.

The proposed market wide parameter is meant to provide market makers with protection from the risk of multiple executions across multiple series of an option or across multiple options. The

risk to market makers is not limited to a single series in an option or even to all series in an option; market makers that quote in multiple series of multiple options have significant exposure, requiring them to offset or hedge their overall positions. The proposed functionality will be useful for market makers, who are required to continuously quote in assigned options classes. Quoting across many series in an option or multiple options creates the possibility of executions that can create large, unintended principal positions that could expose market makers to unnecessary risk. The proposed functionality is intended to assist Exchange market makers in managing their market risk, and providing deep and liquid markets for the benefit to all investors.

While entering values into the proposed market wide parameter will be mandatory, the Exchange notes that market makers who prefer to use their own risk-management systems can set values that assure the Exchange-provided parameter will not be triggered.<sup>4</sup> Accordingly, the proposal does not require members to manage their risk using the Exchange-provided tools. The Exchange expects to implement the proposed functionality in January 2014. The Exchange will provide at least two weeks' notice to members via an Exchange circular prior to implementing the proposed functionality to allow members the opportunity to perform any system changes.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Securities Exchange Act of 1934 (the "Act")<sup>5</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>6</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Exchange believes the proposed rule change enhances its risk management offering to further strengthen risk management for market maker quotes. The proposed market wide parameter is appropriate and reasonable because it offers functionality for market makers to manage their risk. The proposed market

<sup>4</sup> For example, a market maker could set the value for the total number of curtailment events across the market at a high number so as not to trigger the Exchange-provided parameter.

<sup>5</sup> 15 U.S.C. 78f(b).

<sup>6</sup> 15 U.S.C. 78f(b)(5).

<sup>3</sup> See Securities Exchange Act Release No. 70644 (October 9, 2013), 78 FR 62785 (October 22, 2013) (SR-Topaz-2013-06).

wide parameter will protect market makers from inadvertent exposure to excessive risk and thereby allow market makers to quote aggressively which removes impediments to a free and open market and benefits all Exchange members.

The Exchange believes that requiring market makers to set values into the proposed risk parameter provided by the Exchange will not be unreasonably burdensome, as all Topaz market makers currently utilize the Exchange's risk management functionality. Moreover, the Exchange is proposing this rule change at the request of its market makers to further reduce their risk in the event the market maker is suffering from a systems issue or due to the occurrence of unusual or unexpected market activity. As discussed above, the proposed market wide parameter will protect market makers from inadvertent exposure to excessive risk. Reducing such risk will enable market makers to enter quotations without any fear of inadvertent exposure to excessive risk, which in turn will benefit investors through increased liquidity for the execution of their orders. Such increased liquidity benefits investors because they receive better prices and because it lowers volatility in the options market. The Exchange notes a similar functionality is offered by the BATS Exchange, Inc. ("BATS").<sup>7</sup> The Risk Monitor Mechanism provides BATS participants, and particularly market makers, protection from the risk of multiple executions across multiple series of an option or across multiple options. The Risk Monitor Mechanism uses a counting program that users may configure to govern trading. The counting program counts executions, contract volume and notional value, within a specified time period established by a user and on an absolute basis for each trading day. The BATS trading system engages the Risk Monitor Mechanism when the counting program has determined that a user's trading has triggered a setting whereby the Risk Monitor Mechanism then automatically removes the user's orders in all series of a particular option or in all series of all options until the counting program has been reset.

#### *B. Self-Regulatory Organization's Statement on Burden on Competition*

The proposed rule change does not impose any burden on competition. The proposed rule change is meant to protect Topaz market makers from

inadvertent exposure to excessive risk. Accordingly, the proposed rule change will have no impact on competition. Market makers who prefer to use their own risk-management systems can enter out-of-range values so that the Exchange-provided parameters will not be triggered. Accordingly, the proposal does not require members to manage their risk using an Exchange-provided tool.

#### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others*

The Exchange has not solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any unsolicited written comments from members or other interested parties.

#### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Because the foregoing proposed rule change does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate, it has become effective pursuant to 19(b)(3)(A) of the Act<sup>8</sup> and Rule 19b-4(f)(6)<sup>9</sup> thereunder.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

#### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

#### *Electronic Comments*

- Use the Commission's Internet comment form <http://www.sec.gov/rules/sro.shtml>; or
- Send an Email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-Topaz-2014-04 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-Topaz-2014-04. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-Topaz-2014-04 and should be submitted by February 26, 2014.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>10</sup>

**Kevin M. O'Neill,**  
*Deputy Secretary.*

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<sup>8</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>9</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

<sup>10</sup> 17 CFR 200.30-3(a)(12).

<sup>7</sup> See BATS Rules, Chapter XXI, Rule 21.16, Risk Monitor Mechanism.